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RUEHUJA/AMEMBASSY ABUJA 1383
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RUEHBY/AMEMBASSQCANBEQA 0648
RUEHDK/AMEMBASSY DAKAR 1013
RUEHKM/AMEMBASSY KAMPALA 1441
RUEHNR/AMEMBASSY NAIROBI 3824
RUEHFR/AMEMBASSY PARIS 1210
RUEHRO/AMEMBASSY ROME 1863
RUEHBS/USEU BRUSSELS
RUEHGV/USMISSION GENEVA 0599
RHEHAAA/NSC WASHDC
RUCNDT/USMISSION USUN NEW YORK 1604
RUEKJCS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEFDIA/DIA WASHDC//DHO-7//
RUCPDOC/DEPT OF COMMERCE WASHDC
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK//DOOC/ECMO/CC/DAO/DOB/DOI//
RUEPGBA/CDR USEUCOM INTEL VAIHINGEN GE//ECJ23-CH/ECJ5M//

UNCLAS SECTION 01 OF 02 HARARE 001378

SIPDIS

SENSITIVE
SIPDIS

AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR M. COPSON AND E.LOKEN
TREASURY FOR J. RALYEA AND T.RAND
COMMERCE FOR BECKY ERKUL

E.O. 12958: N/A
TAGS: ECON EFIN PGOV ZI
SUBJECT: NO INDICATION OF DOLLARIZATION AS FOREX SCARCITY
GROWS

Summary

¶1. (SBU) Despite Zimbabwe's hyperinflation and the concomitant depreciation of the Zimbabwe dollar, there is no indication of a trend toward either de facto or formal "dollarization" of the Zimbabwean economy. According to local experts, the biggest obstacle to hard currency transactions is an acute lack of foreign currency. In addition, although it remains illegal, the parallel exchange market has functioned relatively efficiently and with reduced risk over the past year. The GOZ would likely do everything in its power to prevent a trend toward the use of hard currency, which would undermine its ability to inflate away domestic debt. End summary.

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Dollarization Not In The Cards - De Facto Or Formal
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¶2. (SBU) Hyperinflation continues to erode the value of the Zimbabwe dollar. The local currency is trading at roughly Z$1800:1 on the street against the official rate, unchanged since July 31, of Z$250:1. This premium of roughly seven-to-one is an all time high. In addition, many goods are priced at the US dollar equivalent and, as predicted, "Project Sunrise", the redenomination of the local currency, had only a temporary effect on the ease of conducting commercial transactions in Zimbabwe dollars. Large amounts

of local cash are once more needed for even minor purchases, a situation which is likely to continue to worsen.

¶3. (SBU) In this context, the question has arisen whether de facto dollarization could be the natural next step in this sharply contracting economy. We asked four local experts for their opinion: economic analyst John Robertson, head of the Association of Money Transfer Agencies Fred Mutanda, economic consultant Peter Robinson, and Deloitte senior partner Tawanda Gumbo. All four said that dollarization was unlikely given Zimbabwe's acute forex scarcity. Neither exports nor remittances were generating enough cash to support dollarization. As a result, cash transactions in hard currency were extremely rare.

¶4. (SBU) The four agreed that the unfavorable official exchange rate had depressed exports and had also made the Diaspora more and more "creative" in sending support back home. Mutanda said, for instance, that overseas Zimbabweans were depositing money into pooled overseas accounts. Informal forex dealers in Zimbabwe, or, in some cases, licensed MTAs until their recent closure by the Reserve Bank of Zimbabwe (RBZ), then paid out the equivalent amount to local relatives in Zimbabwe dollars or vouchers for fuel, food, etc. at the parallel exchange rate. Closing the circle, traders paid the forex dealers in local currency and drew down the overseas-held forex to pay for imports.

¶5. (SBU) The IMF Aricle IV report of 2005 estimated a baseline scenario of US$1.6 billion worth of imports in 2006. Robertson pointed out, however, that a large portion of the

payments for this trade was nowhere officially captured, rendering the country,s balance of payments and trade statistics "totally confusing and nonsensical." Along with Gumbo of Deloitte, which is the auditor of the RBZ, he professed "no idea" of the amount of forex actually circulating in the country.

¶6. (SBU) Robinson commented to the Ambassador on November 16 that as long as the RBZ provided sufficient local currency, continued to prohibit US dollar transactions (officially, at least), and continued to compel big business to bank in the official sector, "there,ll be no dollarization." He added that an infusion of "big bucks" could certainly stabilize the foreign exchange market; on the other hand, if the RBZ established its credibility in managing foreign exchange policy, it could stabilize the market without the backing of US dollar cash.

Parallel Market Helping Economy Function

¶7. (SBU) Our contacts also pointed to the parallel market as a reason why dollarization was unlikely. Although the market remains "illegal," it is thriving. In fact, the government is not only tolerating its existence, it has become the main player in the market. The (RBZ) routinely purchases hard currency on the parallel market. In fact, the local currency it prints for this purpose is a major source of inflation. In addition, the RBZ purchases have contributed to the high demand for forex which recently outstripped supply and quickened the pace of depreciation.

¶8. (SBU) Government involvement in the parallel market may have reduced the risk of prosecution, but it has not ended it entirely. Moreover, the GOZ's propensity for command and control economics means that it is unlikely to legalize such transactions. As a result, although the market is operating relatively efficiently and facilitating commercial transactions, traders are charging a risk premium to individuals and businesses active in the market.

Comment

¶9. (SBU) Every indication is that hard currency cash is simply in too short supply to support dollarization. As the exporting sector shrinks, we expect to see the supply dry up further and to see remittances channeled in ever more creative ways to finance imports and local purchases. In addition, the GOZ can be expected to bitterly resist dollarization, which would curtail its ability to manipulate monetary policy to, for instance, inflate away domestic debt.

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